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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1972

No. 158.

STATE OF MISSOURI EX REL. SOUTHWESTERN BELL TELEPHONE COMPANY, Plaintiff in Error,

vs.

PUBLIC SERVICE COMMISSION OF MISSOURI AND JOHN A. KURTZ, EDWIN J. BEAN, HUGH McINDOE, ET AL., Defendants in Error.

IN ERROR TO THE SUPREME COURT OF THE STATE OF MISSOURI.

REPLY BRIEF FOR PLAINTIFF IN ERROR.

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REPLY BRIEF FOR PLAINTIFF IN ERROR.

There are some errors as to matters of fact in the brief for defendants in error which we may as well point out in the beginning, and suggest their correction. We cite the pages of the brief where the errors occur.

Errors in Defendants' Brief.

1. "The proceedings involve rates, and a valuation basis of rates, on local properties in sixty-five cities and towns, including St. Louis and other large cities in the State, but not including Kansas City, nor the company's toll lines" (pp. 4-5).

The proceedings, as a matter of fact, did involve the toll lines, but the Postmaster General's toll rates were left undisturbed by the Commission. The company had 77 exchanges in the State of Missouri. The Postmaster General increased exchange rates in 65 exchanges only. The Commission lowered, or attempted to lower, the Postmaster General's rates in 46 exchanges only.

2. "Pending the review proceedings, the company appeared again before the Commission with other evidence and evidence of the results of its operations under the rates prescribed in the order assailed, and received from the Commission substantial increases in the rates at the City of St. Louis and at other important towns (Rec., p. 63)" (pp. 4-5).

The order of the Commission was based upon the earnings and expenses of May, June, July, and August, 1919. Pending the review on May 23, 1920, the company appeared before the Commission with proof only as to the conditions then existing at the St. Louis exchange, showing that its net income "has been decreasing steadily, owing to the increased cost of labor and materials, which more than counterbalanced the increase in revenue from added business." (*In re* S. W. Bell Telephone Company, 9 Mo. Pub. Serv. Comm., 664, *l. c.*, 668.)

The company was given some relief, but only in the St.

Louis rates. There were no increases "at other important towns."

3. "The Southwestern Bell Telephone Company, a Missouri corporation, incorporated about January 1, 1917, operates, in the States of Missouri, Kansas, and Arkansas" (p. 8).

The record (p. 148) shows the fact, which is that

> "the company was known as the Missouri and Kanass Telephone Company until about January 1, 1917, and operated in the State of Kansas and in the western half of the State of Missouri. About January 1, 1917, **the company's name was changed to Southwestern Bell Telephone Company.** It then acquired all the property of the Southwestern Telegraph and Telephone Company which operated solely in the eastern half of the State of Missouri, including the city of St. Louis."

The Missouri and Kansas Telephone Company was organized in 18[illegible]2 and has been in active operation continuously since (Rec., p. 149). It changed its name by amendment of its Articles of Incorporation about January 1, 1917, but its corporate identity remained the same.

The Southwestern Bell Telephone Company, therefore, is not the successor of the Missouri and Kansas Telephone Company, as subsequently averred, but is that very company under a new name.

4. "In taking over the properties of the Missouri and Kansas Company, and of the Southwestern Telegraph and Telephone Company as of January 1, 1917, the Southwestern Bell Telephone Company put the plants acquired upon its books at the book values at which they had been carried by the old companies" (p. 9).

As indicated by the correction at No. 3 the Southwestern Company **was** the Missouri and Kansas Company, and, therefore, did not take over the property of the Missouri and Kansas Company at all. The American Telephone and Telegraph Company owned all the stock of the Southwestern Telegraph and Telephone Company and all the stock of the Southwestern Bell Telephone Company (formerly Missouri and Kansas Telephone Company) and the Southwestern Bell Telephone Company acquired all the assets of the Southwestern Telegraph and Telephone Company and assumed all its liabilities and exchanged its stock dollar for dollar for the stock of The Southwestern Telegraph and Telephone Company. It was purely a book transaction. One company was absorbed by the other, the other having stock, debt, and assets exactly equal to the sum of the stock, debt, and assets of the two.

5. "The company gave the value of its property located in Missouri, excluding Kansas City and Independence, as carried upon its books, at $21,473,632" (p. 10).

The fact is that the company gave the **book cost**—not value—of its property located in Missouri, excluding Kansas City and Independence, at not the figure stated, but at $21,837,759, which is exclusive of supplies $375,139 and working capital in addition to supplies $676,045 (Rec., pp. 182-184).

6. "(*c*) The Commission in estimating increased expenses accruing from wage increases recently going into effect overlooked in its calculations the actual length of time that these wage increases were in effect and made its estimate of allowance for wage increases too small.

"This error of the Commission is calculated by plaintiff

in error as being, when extended to the annual period, the sum of $183,000.

"Correction in large measure of this oversight and relief in other respects is shown to have been received by the company in August, 1920" (pp. 13-14).

Correction of this oversight was not received by the company in August, 1920, or at any other time, either as to St. Louis or as to the State as a whole. Rates were raised at St. Louis effective September 1, 1920, so as to allow an estimated net income on the Commission's valuation, available for depreciation reserve and return, of not to exceed 10 per cent. "Allowing 6 per cent for depreciation reserve, the return on the investment will not exceed 4 per cent" (*In re* S. W. Bell Telephone Company, 9 Mo. Pub. Serv. Comm., l. c., 672).

The lesser rates prescribed by the Commission in November, 1919, were in effect from December 1, 1919, to September 1, 1920. How could the company receive any compensation for the oversight of the $183,000?

7. "It is proper to remember that the properties and the established business of the Missouri and Kansas Telephone Company and of the Southwestern Telegraph and Telephone Company, as going concerns, were taken over by the plaintiff in error as of January 1, 1917" (p. 24).

The error has been set forth above.

8. "In the Galveston case the plaintiff company had acquired the property fifteen years before the suit, and the history of the property went back thirty-nine years. In the case at bar the history of the property extended back an equal period and the present company had acquired the property a little more than two years before" (p. 30).

As suggested above, the Southwestern Bell Telephone Company **was** the Missouri and Kansas Company, and has held its property outside the St. Louis area and outside of Arkansas for many years.

9. "The price paid or value placed upon the property as of January 1, 1917" (p. 39).

There was no price paid or value placed upon the property on January 1, 1917. The two companies, all of whose stock was held by the American Telephone and Telegraph Company, were consolidated, the Missouri and Kansas Telephone Company with its name changed being the survivor of the two.

The errors above named may be repeated in other places of the brief than those above named.

These are the principal errors in the statement of facts and, with these corrections, the parties are substantially agreed upon the statement of pure facts.

No Conflict of Testimony on Vital Points.

The first four propositions presented by the Commission in its brief are practically to the same effect, and that is that this court will not review and reverse findings of fact made by the Supreme Court of the State when there is substantial evidence to justify those findings.

We are not seeking to do anything of the kind. The findings of the Supreme Court are the same as those of the Commission and are based upon the same evidence.

As to the valuation, it appears without dispute that the engineers of the Commission and the engineers of the company had in 1913 made appraisals of the St. Louis, Caruthersville, and Springfield properties.

The evidence was positive and undisputed that in 1919 the cost of labor and materials entering into the construction and operation of a telephone plant had increased 50 per cent over the costs of 1913.

It was indisputable that there had been a great increase in these costs in the interval from 1913 to 1919.

To get the value in 1919, the company's engineers added 25 per cent to their appraisals of 1913.

The Commission took the appraisals of its engineers in 1913 as the value in 1919, and measured all the property in the State by that standard.

Increase of Costs and Values Ignored.

The Commission ignored the evidence of increase of costs from 1913 to 1919, and held the fact to be of no relevancy.

The Supreme Court did the same, and held it proper in determining value to base the estimates of the cost of labor and material upon normal pre-war prices (Rec., p. 673).

Increase in cost of labor and material between 1913 and 1919 to any extent whatever was absolutely ignored.

Recurrence to pre-war prices was not apparent in 1919. Prices in 1919 in advance of those of 1913 were not abnormal. The advance had held for so long that in some measure and certainly to the extent of 25 per cent it had become normal.

It is without dispute that the Commission and the Supreme Court adopted the values of 1913 as the basic measure of value in 1919 and allowed nothing for any increase of costs in the interval.

And the result is the same if we assume that the Commission adopted and the Supreme Court approved the book cost of the property as its value in 1919. This also ignored

in toto the increase in costs after the acquisition of the property.

There is no dispute in the testimony as to errors of the Commission in reckoning expenses of operation.

Omitted Labor Item.

The omitted item of $183,000 on account of labor costs is admitted. It amounts to nearly one per cent on the Commission's valuation of the property and reduces the return upon the property to less than six per cent.

The evidence with respect to this was in the record before the Commission. That it was "overlooked" by the Commission means simply that the Commission did not take it into account. And that was true of the Supreme Court. The matter was called to the attention of the Commission in the motion for rehearing filed before it (Rec., p. 49), viz.:

> "Because the Commission in its said orders and decision unlawfully and arbitrarily disregarded and disallowed large items of legitimate expense, **including** increases in payrolls, etc."

It was argued before the Supreme Court on the hearing of the cause by that tribunal, and again called to its attention by the motion for rehearing. It was in the case from beginning to end and at every stage was ignored or disregarded. Whether this is properly characterized as overlooked is a question of verbal nicety which it would be a waste of time to consider at length.

Expense Under License Contract.

And as to the disallowance of $174,048, actually paid under the license contract: There is no dispute that the

money was paid, and none that it was not allowed as expense. But this action of the Commission, it is said, was "not arbitrary, was tentative and is not a ground for reversal here" (Commission's Brief, p. 45).

It appears from the Commission's own report that it decided this adversely to the company in 1913 and in 1919 continued indefinitely this tentative adverse decision, with a promise of reconsideration some time in the future. Six years, we submit, is too long a period to be considered as merely tentative. And what is withheld from the company, to which it is entitled, although tentatively withheld, is taken from it for all time. The tentative decision makes no provision for restoration.

In Love *vs.* A. T. & S. F. Ry. Co., 185 Fed., 321, *l. c.*, 327, the court said:

> "The legislative function in rate making looks to the future and determines what future rates shall be. But when rates, either tentative or final, have been put and are maintained in actual operation under penalty of severe fines, the question whether or not their effect is to take the property of the railroad companies affected thereby without just compensation is a judicial one, conditioned by past or present facts, and the national courts cannot be deprived of jurisdiction of it by the fact that the process of making the tentative rates is yet incomplete. It is as clear a violation of the Constitution, and one as promptly remediable in the national courts, to take the property of a railroad company without just compensation by the enforced operation of tentative rates during the process of their making as by the operation of final rates after that process is complete. Railroad companies that have been, are, or will be de-

> prived of parts of their property devoted to the public use of transportation without just compensation during the continuance of the rate-making process by provisions of a State Constitution, or of a State law, or by orders of a State Commission, prescribing tentative rates and putting them in effect during the rate-making process under severe penalties, may maintain suits for and obtain relief by injunction during the continuance of the rate-making process to the same extent that they may after the process is completed. These suits were not prematurely brought."

Here the Commission had all the facts before it and should, we submit, have allowed this item as one of proper expense.

Counsel say, page 46, that the instant case "is widely distinguishable from Houston *vs.* Southwestern Bell Telephone Company (Advance Opinions, 537) **where it seems no allowance whatever was made."**

The very same contract was involved in that case and in this, and it was under consideration in each case for the same purpose, and a comparison of the records will show that the evidence was substantially the same. The statement of counsel that in the Houston case "no allowance whatever was made" is an obvious inadvertence. The city in that case appealed from the allowance of the payment, but its appeal was denied by this Court.

Counsel seemingly disparage the item as a small one, but it is nearly 1 per cent on the Commission's valuation of the property and with the omitted labor item amounts to $357,048 annually, reducing the return upon the property, on the Commission's basis in every other respect from the 6.81, de-

termined by the Commission to be just and reasonable, to 5.06.

Annual Depreciation.

The defendants in error at page 34 of their brief take up the general question of depreciation, but do not state accurately either the position of plaintiff in error or the underlying principles involved. The record in this case is too meager to permit a full or satisfactory discussion of the question. It is unnecessary to urge it here because it is aside from the questions of valuation and expense which are decisive of this case. It is sufficient to suggest that the attempt to justify the reduction of an estimated depreciation reserve of $3,744,501 as "extinguished value recouped from patrons by charges to depreciation" (Rec., p. 25), is sad irony in view of the company's financial history.

Values of 1913 Not Measure of Values for 1919.

In our consideration of the case and in reaching the conclusion that the rates prescribed by the Commission were confiscatory it has not been at all necessary to stand upon the appraisals of the company's engineers. The Commission erred fundamentally when it took the prices and values of 1913 as the measure of prices and values in 1919. It is indisputable that these had greatly increased by 1919. It was undisputed that the increase was 50 per cent. To some extent prices in 1919 were abnormal, and the engineers of the company adopted 25 per cent as a fair measure of increase to allow. The value of more than five-sixths of the property was so determined and the rest consisted of the later

additions, allowed at cost. Apply the same fair rule to the Commission's valuation of $20,400,000, and we get a valuation of $24,650,000. Upon the difference between these two amounts the company should be allowed a return of 6.81 per cent, amounting to $289,425, or more than the amount by which the Commission reduced its net revenues.

The Commission did not simply disregard the testimony of the company's engineers, to the effect that 25 per cent would be a fair amount to add to the 1913 valuation in order to get a fair valuation for 1919, but it disregarded the common knowledge and indeed its own knowledge on the subject. It confessedly ignored the fact of increase in cost of labor and material between those years, although the company could not. The company must pay for the labor and material involved in the rendition of its service on the basis of 1919 prices, and it was permitted to charge only on the basis of 1913 prices.

As to this there is no conflict of testimony, and there is no denial of this cardinal fact in the Commission's brief.

Adopting the value of the property in 1913 as its value in 1919, when the conditions had so materially changed, was not finding its value in the latter year. We find in the brief of the Commission no justification of this action. All that is said on the subject is to be found at p. 40, viz.:

> "It is suggested that the Commission was arbitrary in applying as it did, the results of its valuation of plaintiff's exchanges at St. Louis, Springfield and Caruthersville. Upon the record here, including the contract made with the Postmaster General, and the conditions under which plaintiff took those properties on January 1st, 1917, the presumption arises

and must be indulged that the findings of value made in those cases must have been acquiesced in, and accepted by plaintiff."

What is the record here on the part of the Commission? It is the evidence offered in 1913, to show the value in 1913, and the findings of the Commission in that year of what the value then was. In the face of the admitted change of conditions, that could not be the value in 1919. It will be contended that the conditions were abnormal, but it must be borne in mind that they had existed for about two years, and there was no promise of present return to the conditions of 1913. What is persistent for so long a time cannot be said to be abnormal. As this Court said in U. S. *vs.* Garbish, 222 U. S. 257, l. c. 261, "the phrase 'continuing extraordinary emergency' is self-contradictory."

The rates prescribed were to be in force during the prevalence of the so-called "abnormal" period, and the service was to be rendered at the so-called "abnormal" cost, and so this abnormal cost should have been taken into account to some extent.

The relevancy of the contract with the Postmaster General is not apparent. It is to the point, but not as sustaining the action of the Commission, that the Postmaster General increased rates and so increased the revenues of the company. He took into account in some measure the existing conditions, and not as anticipating a change, but because he had taken existing conditions into account, the Commission made a reduction in the rates he had established.

The suggestion in the brief as to "the conditions under which plaintiff took those properties on January 1st, 1917,"

is predicated upon the mistakes, Nos. 3 and 4, in the Commission's brief pointed out above. The plaintiff did not take its own property on January 1st, 1917. It already had that property. It did take over or acquire all the property and assume all the liabilities of the Southwestern Telegraph and Telephone Co. and exchange its stock dollar for dollar for that of the last-named company. This had and could have no effect upon the value of the property acquired in any way whatever.

So the case as to valuation resolves itself into this, that the Commission refused to recognize to any extent whatever the change in actual conditions since 1913, rejecting it entirely from consideration as an irrelevant circumstance in fixing rates which were to be current and enforced while that change in conditions continued in existence, and from which there has been no recurrence of what is called "normal" even to this day.

The New St. Louis Case.

That there was something radically wrong in the action of the Commission is virtually admitted.

The company, on May 3rd, 1920, filed a petition asking for an increase of rates at the St. Louis exchange, and filed an amended petition asking a further increase on June 14th, 1920. The Commission made its report upon this case on August 23, 1920 (*In re* Southwestern Bell Telephone Co., 9 Mo. Pub. Serv. Com., 664). It held to its old valuation of the property (p. 668).

As to revenue, expenses and earnings it found (p. 668):

> "The net income of the telephone company has been decreasing steadily, owing to the increased cost of labor and material, which more than counterbalances the increase in revenue from added business. Based on the operations during the month of May, 1920, the estimated annual net income available for return on the investment and depreciation reserve, with the rates at present in effect, is $1,042,143 or 9.71 per cent on a valuation of $10,642,896 as indicated in the following table taken from Applicant's Exhibit No. 16."

Here is a finding of 9.71 per cent received by the company and available for depreciation reserve and return on the investment or less than 4 per cent for return on the investment as determined by the Commission.

"The Telephone Company," says the Commission (pp. 671 and 2), "now finds itself with an annual income $262,244 less than that to which the Commission deems it entitled, and will be forced to increase its wages $431,000 per year in order to render proper service."

In other words, the Commission, as to this exchange, had cut the rates too much by $262,244, on the basis of the service as then being rendered, and as the service should be, too much by $693,244. The proposed increase of rates left the St. Louis rate, both for flat and measured service, lower than that of other large cities mentioned. The rates proposed were approved by the Commission, conditioned that "it proceed immediately to increase its force of operators and make every effort to better the service" (pp. 672-673).

No Reparation for Past Injuries.

This was, of course, a measure of relief to the company, but it did not take effect until September 1st, 1920, and was operative only as to the future.

Counsel say as to this (p. 14):

> "Correction, in large measure, of this oversight (as to the $183,000), and relief in other respects, is shown to have been received by the company in August, 1920."

There was no relief in this as to the St. Louis Exchange for the reduction in rates during the period from December 1st, 1919, to September, 1920, and none whatever as to the State at large. Here was a period of nine months during which, under an injunction and a bond, as provided by the statute of Missouri, Sec. 10523, R. S. Mo. 1919, the difference between the Postmaster General's rates and those prescribed by the Commission was collected by the company and impounded in the depository of the Court where it is still held. The only way of redress for the grievances suffered by the company is to reverse the judgment of the Missouri Supreme Court and to award the money thus impounded to the company. The reduction in rates made by the Commission being unwarranted, the money belongs to the company. The order of the Commission in the last St. Louis case provides no redress for the past, either directly or indirectly. The Commission says of the report cited, *supra*, l. c., 672:

> "The proposed rates will provide an estimated net increase in revenue amounting to $675,834, and the estimated net income of the telephone company available for depreciation reserve and return on an investment of $10,642,896 will not exceed 10 per cent. Allowing 6 per cent for depreciation reserve, the return on the investment will not exceed 4 per cent."

There is nothing in this rate of return that compensates for too low a rate in the past and redress must come, if at all, in the way we have suggested.

The Orders of the Commission Subject to Review by This Court.

The Commission specifically contends as to the payment under the license contract that its action was tentative, and for that reason not a ground for reversal (Brief, p. 45).

And, again, in its summary that "the order attacked was not final in form or substance," and cites the Cedar Rapids Gas Co. Case, 223 U. S., l. c. 669, in support of its view. The cases are very different. Here we are dealing with ascertained and admitted facts. The valuation here made by the Commission was wrong in the principle of its determination and to the extent of the wrong operated to deprive the company of its property. This was inherent in the action of the Commission. On practically twenty-five per cent of its property it was precluded from receiving any return.

And so as to the expenses properly incurred by the company and actually paid by it, the disallowance operated by its own force to deprive the company of its property, to the

extent of the expenses so disallowed. For money properly expended in the rendition of the public service in which it was engaged, a part of the cost of that service, the company was not permitted to reimburse itself out of the receipts for that service.

In what respects did the order of the Commission lack finality in form or substance?

They were made effective December 1st, 1919. From that time on the company could charge only the rates in which inhered the vices we have pointed out.

Section 10514, R. S. Mo. 1919, provides that:

> "Every telegraph corporation and every telephone corporation, and all officers, agents and employees of any telegraph corporation or telephone corporation, shall observe, obey and comply with every order, direction or requirement made by the Commission under the authority of this chapter so long as the same shall be and remain in force. Any telegraph corporation or telephone corporation which shall violate any provision of this article, or which fails, neglects or omits to obey, observe or comply with any order or decision or any direction or requirement of the Commission shall forfeit to the State of Missouri not to exceed the sum of one thousand dollars for each and every offense; every violation of any such order or decision or direction or requirement, or of this article, shall be a separate and distinct offense, and in case of a continuing violation, every day's continuance thereof shall be and be deemed to be a separate and distinct offense."

Instant and constant obedience to the order complained of was thus secured under penalties so heavy that the com-

pany dare not incur them, and it must rather incur the loss from day to day resulting from the operation of the property under the prescribed conditions.

This would be so were it not for article VI of chapter 95, R. S. Mo. 1919, which prescribes the "Procedure Before Commission and Courts."

This chapter provides for a review of the action of the Commission by the courts in the very way in which we have sought it. There is no suggestion that we have made any mistake of form. Section 10523 of article VI provides for a stay or suspension of the order of the Commission, upon giving a proper bond, pending the review proceedings, and that the court may further order payment into court or into some bank or trust company "all sums of money which it (the public service corporation) may collect from any corporation or person in excess of the sum such corporation or person would have been compelled to pay if the order or decision of the Commission had not been stayed or suspended." This money remains impounded until the termination of the review proceedings, when it is to be disposed of in accordance with the final determination of the cause.

Now to say that this mode of review, with all its incidents of protection in their rights to all parties concerned, is not permissible to the fullest extent, is to say that what the State has given with one hand it has taken back with the other. This the State has not done, nor could it constitutionally do anything, although characterized as "tentative" and "temporary," which had inherently the effect to deprive, irremediably, the company of its property without due process of law.

The company is plainly entitled to a review of this case upon the merits.

Respectfully submitted,

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